



The Nest Report

Year End, 2009

A comprehensive and transparent analysis of the residential real estate market in Charlottesville, Albemarle, and surrounding counties, prepared quarterly by Nest Realty Group.

2009 is Finally Over

Summary

There is no way or reason to put a positive spin on 2009 as a whole. It was a disaster for the US economy, and for homeowners in particular. Over the last twelve months, the broad market indicator Case Shiller Composite-20 is down 5.3%, but even this doesn't tell the half of it. Of the twenty MSAs included in that Composite Index, only four saw increases in home values over the past twelve months, the greatest increase was Dallas at a lethargic 1.4%. Sixteen MSAs saw a loss; losses as high as 24.5% in Las Vegas, more than 13% in Tampa, and even 8.5% in Chicago. No region of the country was immune to the effects of the market.

2010 will be an interesting year to watch. Employment numbers continue to creep higher throughout the country and the state; national debt and deficit levels are of a constant concern; the foreclosures and short sales will increase; and yet there are positive signs that our market is making a stride toward normalcy. Number of transactions increased from Q2 to Q3. On a seasonally adjusted rate, sales increased from Q3 to Q4 by more than 10.8%. Charlottesville remains lowest of all Virginia for unemployment rates. And while statewide and nationwide unemployment numbers are up, Charlottesville has fallen for four straight months (Aug thru Nov) to 5.1%, which is lower than we have seen since December of 2008.

The big "what-if" for 2010 will be keeping an eye on Short Sales and Foreclosures across Central Virginia. We will go into this in more detail, but the basic issue is that Short Sales are up all across our state, and Charlottesville is not completely immune. Foreclosures are up significantly in Central Virginia, but are still way behind rates in other parts of the state. If that trend ends, and Central Virginia catches up with Richmond and Northern Virginia, we will see a significant erosion on prices throughout this year. As it stands, signs point to another 6-9 months of price drops followed by some stabilization, but no sign of increases in the next 18-24 months.

The Broad Market

Around Charlottesville, we saw transaction volume drop, prices slide, and then a nice uptick toward the end of the year. But not enough to save the year entirely. Across the EMSA (Charlottesville City, Albemarle, Fluvanna, Greene, Louisa & Nelson Counties) the numbers were dreary reminders that Charlottesville, while insulated, is not completely resistant to all the national issues. Average and median prices were down, number of transactions were down, total volume was down, and throughout, days on market continued to be higher than the year prior.

EMSA - 12/31 Year To Date - Detached Home Sales

	Median Sales Price (\$000)	Average Sale Price (\$000)	# of Closed Sales	Volume of Sales (\$M)	Days on Market
2009	283.6	363.2	1664	604.4	120
Change	-7.6%	-10.1%	-7.8%	-17.1%	2.6%
2008	307.0	404.2	1804	729.1	117

But there were some high points for Central Virginia. In the fourth quarter, we saw an uptick in sales. While the average and median prices showed their weaknesses, the buyers came back to the table and increased the number of transactions by more than 35% compared to the Q4 of 2008, bringing the total volume of sales up nearly 20%. But don't get too excited yet - Q4 2008 was one of the worst quarters on record. In the City of

Charlottesville, there have been only 2 quarters with fewer sales in the past ten years. In Albemarle, there was only one quarter with fewer sales - Q1 2009.

EMSA - 4th Quarter - Detached Home Sales

	Median Sale Price (\$000)	Average Sale Price (\$000)	# of Closed Sales	Volume of Sales (\$M)	Days on Market
2009	269.0	366.7	425	155.8	123
Change	-10.9%	-12.8%	35.8%	18.3%	4.2%
2008	302.0	420.8	313	131.7	118

However, we are not looking to discount that sales have gone up. Last quarter, we pointed to the fact that the 3rd quarter saw more sales than the 2nd. We could never have expected that 4th quarter should beat 3rd quarter, and it didn't. In fact, it dropped off 21.4% from 3rd to 4th quarter. However, based on studies we performed last year on seasonal adjustments and expected sales, we found that the 4th quarter sales put us on a pace for over 2,000 sales in a year, 23% higher than our year total, indicating that we are at least moving in the right direction.

Foreclosures

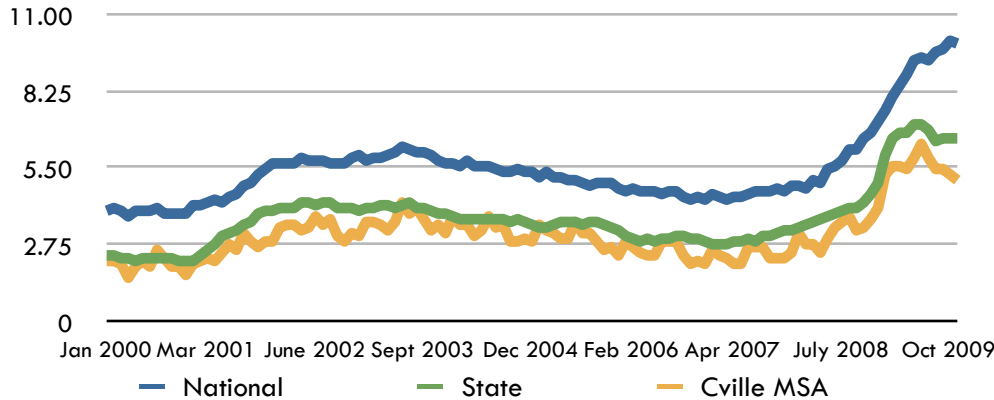
There are certainly readers who would hope that we might not lead off this report with a discussion of foreclosures, but foreclosures and short sales are an important factor in our ability to recover locally, regionally and statewide. Foreclosures are in the news and are on the rise, but when you compare Virginia and Charlottesville to the rest of the US, it is quite clear that our problems are mild compared to much of the US.

The first wave of foreclosures was based on sub-prime borrowing practices. According to the NY Fed, in states such as California, Nevada and Florida where price escalation was unprecedented, the rates of sub-prime borrowing reached levels of 21.6, 20.2 and 25.5 loans per 1,000 housing units respectively. Contrast that with Virginia where only 11.9 loans out of each 1,000 units were sub-prime. Factor in Alt-A loans and California has another 35.2 loans in Alt-A. Virginia has just over 10.7.

The current wave of foreclosures across the country are being blamed on economic conditions beyond the borrowing practices. This means that currently homeowners are losing their homes not necessarily because they made bad decisions in the buying process, or overextended themselves; but rather because they *had* been making payments on "aged mortgage loans" but have now lost their jobs and are unable to find new comparable work at comparable pay. This is where Virginia and Charlottesville really look strong.

In December, 43 out of 50 states saw unemployment rise. Virginia was one of them. However, while the national unemployment rate is over 10%, Virginia is still right around 6% and Charlottesville leads the Commonwealth with 5.1% and four straight months of unemployment reductions. (*December numbers had not been released for individual MSAs as of this writing.*) This does not take "underemployment" into account, and we admit that this is likely happening in Charlottesville as much as any employment center, but people are working, and this is going to come into play in 2010.

National, State, and MSA Unemployment Figures



Finally, the current delinquency rates. Louisa and Orange both have more than 5% of current mortgages with 90 day delinquencies. Culpeper, which is more Northern Virginia than Central Virginia, has over 6.3% of loans delinquent. Otherwise, our area appears fairly clear of debt issues thus far. Charlottesville City has only 1.6% delinquency rate, which is the second lowest rate among the 40 independent cities in Virginia. Lexington is the lowest with 1.33%. Manassas is the highest with over 9% delinquent. Albemarle County has 1.57% and Nelson 1.50%.
 (Source: NY Federal Reserve Web Site)

We are not pretending that the country has not been in a severe recession, or that Charlottesville MSA is immune to the issues that are holding back a housing recovery in other areas. But we do believe that Central Virginia has weathered the storm fairly well. The unemployment numbers are incredibly reassuring for our MSA. Milton Friedman posited some 40 years ago that unemployment below 6% was unhealthy and below the “natural rate of unemployment”. In that sense, we are in a very balanced position. It keeps our jobs and wages in check. We are certainly better off than much of our country. If Central Virginia can stay below the curve, we believe we will see our foreclosure rate lower than the national and state averages, and that will help our prices stabilize more quickly.

One item outside of the question of rates and jobs are strategic defaults. This will be a trend that we see growing as home prices sink deeper into “underwater” positions. For buyers without large cash positions, the option of walking away from a home rather than losing money by continuing to pay will become more appealing. According to one source, by June of this year 10% of Americans will owe 25% more on their house than it is worth. The shrinking level of equity will change the way Americans look at their home.

City of Charlottesville, Detached Housing

Possibly the highlight of this whole quarter’s report can be seen in the following chart. The City of Charlottesville was strong in the 4th quarter, relative to last year. Average prices were up modestly, but more importantly the average price paid per finished square foot was up. The number of sales were up tremendously and the days on market were down. The big question that remains is: What impact did the \$8,000 first time home buyers credit have on these sales? We know of no way to quantify this other than to wait and see how the first and second quarters of 2010 play out. Reduced sales in the first quarter will indicate this was an artificial bump in sales. Continued upward trajectory could either indicate that the credit is still playing a role, or that the market really is turning.

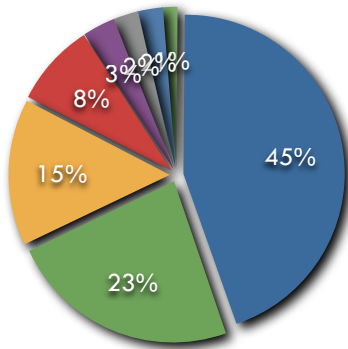
City of Charlottesville - 4th Quarter Detached Home Sales

	Average Sales Price (\$000)	Median Sales Price (\$000)	Average Price / Sq. Foot	# of Closed Sales	Volume of Sales (\$M)	Days on Market
2009	334.0	280.0	\$169.48	60	20.0	82.3
Change	0.6%	-3.9%	3.1%	42.9%	43.7%	-18.5%
2008	332.2	291.5	\$164.40	42	14.0	101

Last quarter, we looked at the breakdown of sales in the city based on price point. We continued this analysis this quarter as well. The graph on the top of the following page is for the full year 2009 and shows the prevalence of sales in the lower price points. In the 3rd Quarter, 69% of detached home sales occurred at prices below \$325,000. For the full year, that amount was 68%.

**City Detached Home Sales by Price Category (\$000)
Jan 1, 2009 - Dec 31 2009**

- <250
- 250-324
- 325-399
- 400-499
- 500-599
- 600-749
- 750-1000
- >1000

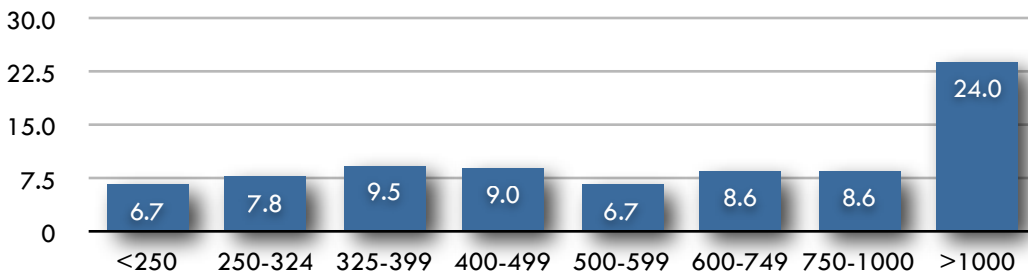


The large percentage of sales in the sub-\$325k is not surprising given that the city lists 68% of single family homes as below \$325k in assessed value; however, what is surprising is the percentage of sales against the percentage of listings in each category. The percentage of listings in the sub-\$325k category is only 61%.

The flip side of this equation is the lopsided listing:sales ratio of homes in the city over \$1 million --- 4% of listings and only 1% of sales. While we are talking about the price category with the smallest number of transactions, it is important to note that there are eight current listings compared to only four sales in the last twelve months. It is the one price category for which there is really no parity. The result of this is Months of Inventory that is not in line with the rest of the market.

Months of Inventory has been calculated by taking current inventory and dividing it by the average number of sales in a month during 2009 for each price category.

Current Months Inventory for City Detached Homes by Price Range (Based on 2009 sales)

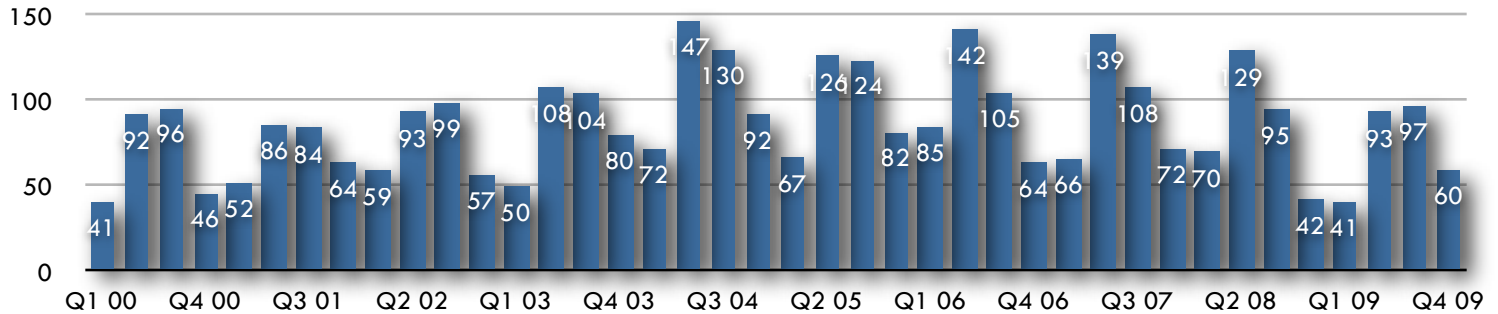


The months of inventory is always important, as it gives us an indication of the absorption rate within the market. As we move into the spring selling season, a high number of residual listings from the Fall -- or even from last Spring in many cases -- can be a concern for sellers, as these "old listings" will

take away exposure for new listings. The current average CDOM (Continuous Days on Market) of city listings is 213 days. These sellers can begin adjusting sales price and thus bring prices down across the market. Some will say that this is simply sellers becoming realistic about the values of their homes, others may call it desperation. Either way, prices of these homes must be reduced to garner the purchasers attention and a contract. Additionally, we have spoken in the past of the high number of listings that went unsold that are currently not on the market, but for which

the seller would still like to sell the property. The unknown size of this “shadow inventory” is also a concern that will monitor.

Number of Sales by Qtr - City of Charlottesville



We pointed out in the Summary that the seasonally adjusted numbers for Q4 were greater than Q3. This is true of the total EMSA, but not the city of Charlottesville Detached Homes. In fact sales are down seasonally more than 13.5% in the fourth quarter from the period before. Granted, we are still up some 42+% from the same period in 2008, but these are still mixed messages. On a seasonally adjust rate, we will be hoping to see more than 53 sales close in the first quarter of 2010 if we are really seeing any increased activity in the market.

Albemarle County - Detached Housing

Albemarle was more consistent with the EMSA as a whole than the City was. Prices were down, prices per square foot were down, and the number of sales were up. As we look at other areas of Virginia, specifically Northern Virginia, this is what we have seen elsewhere. Sellers become realistic about prices on their homes, and with those downward movements in asking price, greater activity occurs. Unfortunately for sellers still in the market, it is unlikely that we will see these trends reverse any time soon. Northern Virginia saw a solid 9 months of price drops even after sales picked up before their prices leveled. The good news is that the inventory was reduced to the point that they now have a sellers market in several price points.

It is still a little early to predict the same here in Albemarle, but it is not out of the question. Inventory levels will play the crucial role in price stabilization. If we continue to see higher levels of short sales and foreclosures, then sellers will not be able to influence properties in any meaningful way. However, if Albemarle can keep foreclosures low, then we may only see another 5% drop in prices.

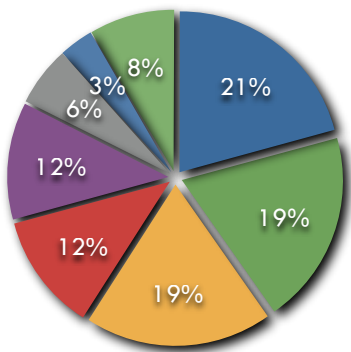
As we move into 2010, as with the City, we are going to be looking closely at the number of sales and the price drops. We anticipate a median price at the end of Q1 around \$355,000 and total sales in the first quarter of between 130 and 140. If sales are above that, then the market is rebounding faster than we have seen for the last few quarters. Q4 was down if you take into account seasonal adjustments. 137 closings in Q1 2010 would be even with the fourth. As for the sales price, it is possible that we will see prices move further, faster. Homes that close in the first quarter are homes that have been on the market through the tough holiday season in many cases, and may have a higher number of short sales. We will look further at this in April.

Albemarle County - 4th Quarter Detached Home Sales

	Average Sales Price (\$000)	Median Sales Price (\$000)	Average Price / Sq. Foot	# of Closed Sales	Volume of Sales (\$M)	Days on Market
2009	523.6	365.0	\$173.84	155	81.2	128
Change	-18.0%	-12.9%	-18.1%	31.4%	7.8%	1.1%
2008	638.3	419.2	\$212.19	118	75.3	126.56

4th Quarter Albemarle County Detached Sales By Price Range

- <250
- 250-324
- 325-399
- 400-499
- 500-599
- 600-749
- 750-1000
- >1000



With the City of Charlottesville physically located inside the county of Albemarle, there is an assumption that the markets are similar. While we would not assert that they are unrelated, they are certainly individual. To the left are the 4th quarter sales from Albemarle County broken down by the same price categories as they city chart on page 4. However, these results could not be more different. Where 68% of city sales were under \$325,000, only 40% of county sales fall into this category (33% in the same period in 2008). And while just 1% of city sales were over \$1 million, a full 8% of Albemarle sales in the 4th quarter were this large (12% in Q4 2008). In general, a fairly balanced sales distribution.

Below are the statistics by high school district. I provide these, as many people feel that the high school districts are more accurate demonstrators of neighborhood movement. However, we note that with so few sales in a quarter, it is difficult to believe that these stats are as meaningful as the larger countywide data. For instance, when looking at the Western Albemarle High School numbers, it is not accurate to say that home prices are down either 23, 28, or 34% (Median Price, Average \$/SF, and Average Price). In 2008, there were several very large properties that traded that threw all the numbers off for the quarter. We believe that the erratic numbers in the charts below supports our assertion that small data sets can be misleading, and should be used with caution.

Albemarle High School - 4th Quarter Detached Home Sales

	Average Sales Price (\$000)	Median Sales Price (\$000)	Average Price / Sq. Foot	# of Closed Sales	Volume of Sales (\$M)
2009	498.1	326.0	\$164.42	59	29.4
Change	12.9%	1.4%	0.1%	73.5%	96.0%
2008	441.0	321.5	\$164.33	34	15.0

Monticello High School - 4th Quarter Detached Home Sales

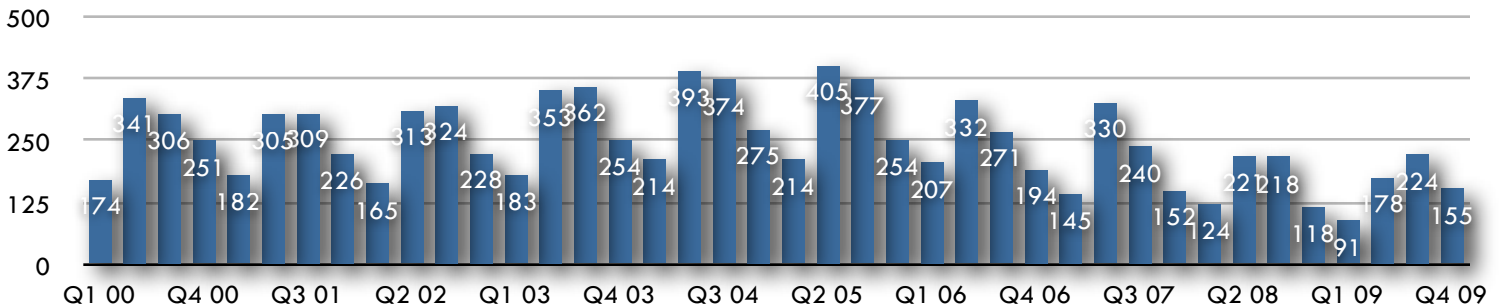
	Average Sales Price (\$000)	Median Sales Price (\$000)	Average Price / Sq. Foot	# of Closed Sales	Volume of Sales (\$M)
2009	512.9	366.0	\$163.66	35	18.0
Change	-18.9%	-13.3%	-14.7%	-5.4%	-23.2%
2008	632.1	422.0	\$191.94	37	23.4

Western Albemarle High School - 4th Quarter Detached Home Sales

	Average Sales Price (\$000)	Median Sales Price (\$000)	Average Price / Sq. Foot	# of Closed Sales	Volume of Sales (\$M)
2009	512.9	366.0	\$188.79	60	33.8
Change	-34.7%	-23.8%	-28.2%	27.7%	-8.4%
2008	785.9	480.0	\$262.77	47	36.9

Overall sales in the county are not surprising. The fourth quarter sales did not exceed the 5 year or the 10 year average for quarterly sales. Over the past 5 years, there have been an average of 222 sales in a quarter compared to this year's 155. The 10-year average is even higher with 249 sales. The 5-year average for the fourth quarter - 175 - is also higher than this year. While the sales have been increasing, it is important to remember that our sales figures are still no where near where the sales historically have been. Looking at seasonal adjustments, sales in Albemarle were down just under 5% from the 3rd Quarter.

Number of Sales by Quarter - Albemarle County



Attached Home Sales

How much impact can two companies have in the real estate market? When one looks at Attached home sales, one realizes very quickly that the answer can be "enormous". Ryan Homes and Southern Development have dominated the market recently in attached homes, and the fourth quarter supports that claim. In the city, sales of attached homes shrank from 19 to 17 sales in the fourth quarter from 2008 numbers, but, including re-sales, 8 of those 17 sales were in Southern Development neighborhoods. Look at Albemarle County, where Ryan homes is building at Abingdon Place at Hollymead and both Ryan and Southern Development are building at the Pavilions at Pantops and you find a 162% growth in attached home sales from 29 to 76 sales from the fourth quarter of 2008

to 2009. In Albemarle, 10 of these 76 sales were Southern Development and 17 sales were from Ryan Homes. Across all of 2009, there were 82 sales at The Pavilions at Pantops.

Charlottesville City - 4th Quarter Attached Home Sales

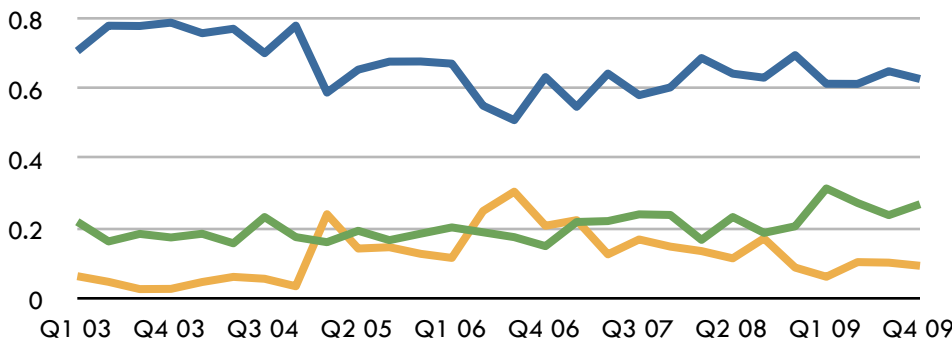
	Average Sales Price (\$000)	Median Sales Price (\$000)	Average Price / Sq. Foot	# of Closed Sales	Volume of Sales (\$M)	Average CDOM
2009	222.4	238.6	\$133.97	17	3.8	157
Change	-10.3%	-13.7%	4.1%	-10.5%	-19.7%	11.7%
2008	247.9	276.6	\$128.66	19	4.7	141

Albemarle County - 4th Quarter Attached Home Sales

	Average Sales Price (\$000)	Median Sales Price (\$000)	Average Price / Sq. Foot	# of Closed Sales	Volume of Sales (\$M)	Average CDOM
2009	259.2	230.0	\$132.21	76	19.7	98
Change	0.1%	-8.7%	-8.2%	162.1%	162.4%	-7.4%
2008	258.9	251.9	\$144.00	29	7.5	106

For many buyers, attached homes represent an affordable solution to housing. The number of builders entering this market is growing, and Ryan is expanding their reach into additional neighborhoods. Recently, Ryan closed on land in Western Albemarle and is expected to have a large impact in that area's sales volume and prices. Owners of existing high-end townhouses will find that the price pressures exerted by Ryan Homes, Piedmont Realty, Southern Development and others will reach into all townhouses, not just new construction.

Product Mix (Based on Total Number of Sales)



The percentage of homes sold in Central Virginia that are detached, single family homes has remained fairly constant since 2006, hovering around 60%. The growth in attached home sales has come at the expense of condominium projects. Part of this shift is because fewer condo projects are being built, but the one other factor is that condo financing became difficult in 2007. Financing has gotten better, as more projects are jumping through the

required hoops to become FHA approved, but there is still a perception in the mind of buyers and many Realtors that financing is not available, or at least difficult. Townhouses are not facing the same problems, and the price points now are right for buyers. The median price for a townhouse is now a whopping 37% below the median for detached homes. And given that many of the townhouses are new construction, this discount seems too good to pass up for many buyers.

Condominium Sales

Shrinking to less than 10% of the market for all of 2009, condominium sales are languid at best. In the 4th quarter, we saw only 33 sales of condos, 42% in the City and 58% in Albemarle County. Once thought of as the least expensive way to own a piece of real estate, that may not be playing out. Projects in downtown Charlottesville regularly seek buyers that can choose between detached homes and condos. Projects are having to attract buyers based not on financial merit, but on lifestyle.

City of Charlottesville - 4th Quarter Condominium Sales

	Average Sales Price (\$000)	Median Sales Price (\$000)	# of Closed Sales	Volume of Sales (\$M)
2009	204.8	172.0	14	2.9
Change	-24.5%	-11.1%	16.7%	-11.9%
2008	271.1	193.5	12	3.3

Albemarle County - 4th Quarter Condominium Sales

	Average Sales Price (\$000)	Median Sales Price (\$000)	# of Closed Sales	Volume of Sales (\$M)
2009	149.4	137.0	19	2.8
Change	-32.0%	-17.0%	111.1%	43.5%
2008	219.9	165.0	9	2.0

Median condominium price in the City is only \$172,000, which is lower than the attached median price by \$66,000. However, if you look at the price breakdown of active listings in the condo market you see something very different. **30% of the listings are for more than double the median sales price.** There are still condos in the marketplace for the entry level buyer, and they are selling. What is not selling are the condos designed for the young professional or empty nesters. Of the 66 condos that sold in all of 2009 in the city, only 7 were for more than \$375,000, and only 1 of these condos was new construction. There are 12 condos in this category actively listed currently, and 12 Gleason units available, but not listed.

2010 is going to answer some questions, and will likely add some more. The Gleason Building, currently under construction in Southwest Downtown, will be completed this year, with delivery of residential units most likely occurring in the second quarter. Those units are all being offered in this upper echelon pricing. Once completed, and once reserved units close, there will be another 12 units available to a market that is already saturated. However, the completion of this project may bring some added interest in the downtown market and could bring sales to other projects as well.

Interest Rates

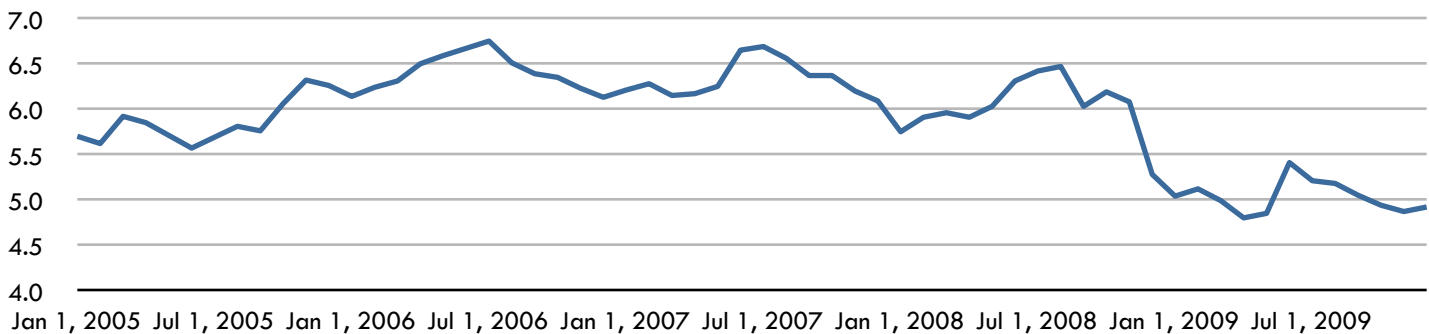
Perhaps we should have led with this section. Other than Short Sales and Foreclosures, this has the potential to have the greatest impact on home prices in 2010. And while the impact has not yet been felt, the potential hype has begun. The Fed continues to claim that they will cease purchasing mortgage backed securities from member banks around the end of March. This means that if no one steps up to the plate, that mortgages that have been written will sit in the offering banks books, and not be sold. This means that there will not be any more money to lend. If this

plays out, this could be the equivalent of the 2008 credit freeze in commercial lending from which we still have not yet recovered.

However, all of this is based on the assumption that this game of chicken is one that the Fed is willing to play fully. If they do back out, the only answer will be for banks to charge interest rates that carry the reward of excess risk. This translates -- **“mortgage rates must go up”**. Many analysts are predicting 1% to 2% increase. That could mean close to 7.00% interest rates before the end of the Summer. On a \$350,000 house with an 80% mortgage, this means a Principal and Interest payment increase from \$1,503 to \$1,862. Household income needed to qualify for such a mortgage would go from \$64,000 to \$79,000.

Again, all of this is based on the Fed really backing out of the secondary market and allowing market rates to rule. Currently, they are keeping rates artificially low to keep the housing market moving. If they stop, all bets are off. If buyers take the tact of trying to hold mortgage payments constant, then the home prices would need to adjust downward roughly 10% for every 1% of mortgage rate adjustments. My prediction is that the Fed will indeed stop buying the securities and sit on the sideline for 30 days to see what happens. When it is clear that the housing market is stalled, they will once again resume buying.

30 Year Fixed Rate Mortgage Rates 2005-2009



Source: FreddieMac

Conclusions

2010 will be about the national market and not just local stories. Unemployment will drive foreclosures and excess supply. Interest rates will control limiting demand. If unemployment and interest rates converge, price drops are not just possible, they are guaranteed. If, however, unemployment can stay stable and interest rates are affected, but only modestly, we could see a continuation of the recovery that we saw in the 3rd and 4th quarter. The weather in January and early February is certainly going to decrease the number of closings, as there have been few days in which buyers have been able to shop without weather being a factor.

All in all, we believe that compared to the rest of the US, the Charlottesville market has fared relatively well. However, prices are down and will continue to fall. Sellers that are attempting to chase the falling market with small listing price adjustments are unlikely to find buyers at prices they are hoping for. For sellers, pricing the home competitively may not be enough. Sellers may need to move to prices that drive multiple offers in order to close in on one.

For buyers, interest rates are going to rise. Now is a good time for those with long time horizons. While prices will continue to fall, the ownership costs may not. Buyers need to consider monthly mortgage payments along with principal reduction though payments as part of their equation. Buyers may find that even if prices fall 7-9% more, that buying today could make better financial sense in the long run.